SECTION TWO

HEARING AGENDA AND BACKGROUND PAPER

California State Senate

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ON
BANKING, FINANCE & INSURANCE

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INFORMATIONAL HEARING

Preserving the American Dream: Homeownership Preservation and the Subprime Mortgage Crisis

Tuesday, August 21, 2007
9:30 AM – 12:00 PM
State Capitol, Room 112

I. **Introduction and Welcoming Remarks** – Senator Michael J. Machado, Chair

II. **Economic Impacts of Rising Foreclosures: When people lose their homes to foreclosure, who else gets hurt?**

Allen Prohofsky, Senior Economist, Legislative Analyst's Office

III. **Barriers To Home Loan Restructuring: What barriers exist, and what steps are being taken to remove them?**

George Miller, Executive Director, American Securitization Forum

IV. **Loan Restructuring: What *is* being done to help keep people from default and foreclosure?**

<u>Lender and Servicer Panel:</u>

Ed Delgado, Senior Vice President, Default Information and Analytics, Wells Fargo

Paul O'Leary, Director of Consumer and Mortgage Lending, HSBC Finance Corporation

Lender and Servicer Panel: Continued

Michaela Albon, Senior Vice President and General Counsel -- Home Loans, Washington Mutual

Shane Ross, Senior Vice President of Account Management, Litton Loan Servicing

Counseling Organizations:

Lupe Hernandez, Management Consultant, Neighbor Works America

Jeff Schrager, Team Leader, No Homeowner Left Behind (Central Valley), and President, Realty Blue, Inc.

Martha Lucey, President, ByDesign Financial Solutions (Central Valley and Los Angeles)

Regulators:

Stan Ivie, Regional Director, San Francisco Office, Federal Deposit Insurance Corporation

John Olson, District Manager – Community Development, Federal Reserve Bank of San Francisco

Jeff Davi, Commissioner, California Department of Real Estate

Preston DuFauchard, Commissioner, California Department of Corporations

Michael Kelley, Commissioner, California Department of Financial Institutions

Carrie Lopez, Director, Department of Consumer Affairs

V. **What More Should We Be Doing?**

Bob Gnaizda, Policy Director and General Counsel, Greenlining Institute

Alan Fisher, Executive Director, California Reinvestment Coalition

Paul Leonard, Director, California Office, Center for Responsible Lending

VI. **Public Comment**

INFORMATIONAL HEARING ON HOMEOWNERSHIP PRESERVATION AND THE SUBPRIME MORTGAGE CRISIS

SENATE BANKING, FINANCE & INSURANCE COMMITTEE

MICHAEL J. MACHADO, CHAIR

BACKGROUND PAPER

INTRODUCTION

In January and March 2007, the Senate Banking, Finance & Insurance Committee held informational hearings to investigate the origins of, and to identify workable solutions to, the problems California was experiencing in its mortgage markets. Those two hearings were primarily focused on identifying the steps that needed to be taken to halt the issuance of risky loans that were causing the market disruptions. During those hearings, the Committee heard from industry practitioners, consumer advocates, federal and state regulators, and economists about the importance of adequate loan underwriting; the provision of clear, balanced, and timely explanations of loan terms to borrowers; and consistent application of regulatory guidance across industry participants. The Committee also learned that great focus should be placed on housing sustainability, rather than on housing attainability.

In the time since this Committee's two initial hearings, a great deal has changed. In part due to market corrections, and in part due to federal and state regulatory actions, lenders have tightened their underwriting standards significantly, relative to the standards in place during 2005 and 2006. The media has been filled with reports of lenders' decisions to restrict the use of stated income loans and simultaneous second liens, increase the credit scores necessary to obtain products with multiple layers of risk, take greater steps to verify borrowers' ability to afford their loans after interest rate resets, and improve oversight of mortgage brokers. A great deal of emphasis has also been placed upon the need for due diligence by borrowers seeking mortgage loans. While the situation in today's mortgage market is far from stable, it is clear that many of the abuses which prompted this Committee's January and March hearings have abated. While the Committee will continue to keep a watchful eye on developments in the mortgage market, it has chosen to redirect its immediate focus to borrowers whose mortgage interest rates are about to reset.

On August 21, 2007, the Senate Banking, Finance & Insurance Committee will convene its third informational hearing on mortgage lending, and will hear from a variety of experts about several aspects of homeownership preservation within the current mortgage environment. Witnesses will discuss the regional and statewide, social and economic and implications of foreclosures; address barriers that can hamper efforts to develop loan workout plans designed to keep people in their homes; review what is currently being done by industry, non-profit organizations, and government to minimize defaults and foreclosures; and hear from consumer groups about what more needs to be done in that regard.

THE SCOPE OF THE PROBLEM

According to the Mortgage Bankers Association, 46,265 homes in California were in foreclosure in March 2007. Another 76,732 mortgage loans were seriously delinquent. The vast majority of the problematic loans were subprime adjustable rate mortgages (ARMs), which are failing at a rate of about 15 times higher than prime loans. As of March 2007, 4.84% of all subprime ARMs in California were in foreclosure, and another 7.5% of all subprime ARMs were seriously delinquent.

Some California regions are being hit harder than others. Areas with large numbers of subprime loans are concentrated in the Central Valley and the Inland Empire. According to First American LoanPerformance, the five metropolitan statistical areas (MSAs) with the highest concentrations of subprime loans at the end of 2006 included Merced (21.56 of all mortgages were subprime as of December 2006), Bakersfield (20.23%), Riverside-San Bernardino (19.91%), Stockton-Lodi (19.78%), and Modesto (18.23%).

First American LoanPerformance also tracked the percentage of all subprime loans that were delinquent in each MSA as of December 2006. Sacramento topped the list, with 14.12% of all subprime loans delinquent. Three of the MSAs with the highest concentrations of subprime loans were also in the top five MSAs with the highest percentage of delinquencies (Modesto with 13.18%, Stockton-Lodi with 12.74%, and Merced with 12.24%).

Unfortunately, many experts believe that the delinquency and foreclosure numbers will get worse before they improve. Loans originated during late 2005 and all of 2006, a period of peak origination volumes and decreased underwriting quality, are only now beginning to reset in large numbers. According to Credit Suisse, the peak month for interest rate resets will come this October, when more than $50 billion in mortgages nationwide will reset from introductory teaser rates to new, higher rates. The level of first-time resets will remain above $30 billion per month through September 2008. In all, the interest rates on $1 trillion in mortgages (12% of the nation's total) will reset for the first time in 2007 or 2008.

The significance of rising defaults and foreclosures extends beyond the individuals and families who lose their home equity and their homes. While less than 1% of *all* loans in California (prime and nonprime, fixed and adjustable rate) were in foreclosure as of March 2007, certain neighborhoods saw much higher percentages of foreclosures and short sales. (A short sale is one in which the institution that holds the mortgage agrees to accept less than it is owed upon sale of the house, in lieu of foreclosing on the property). A neighborhood's housing prices tend to become depressed when large numbers of homes go on the market; house prices are depressed even further when many of the homes for sale are being sold at bargain basement prices by banks and other lending institutions through foreclosures or short sales.

The combination of depressed home prices in certain areas, together with California's already slow housing market and a tightening of mortgage lending standards, has caused significant pain among many whose incomes are dependent on California's real estate market. New housing starts are down, along with construction spending; mortgage brokers, loan officers, real estate salespersons, and real estate brokers have significantly less business, and therefore lower income; many real estate and housing construction professionals have lost their jobs; restrictions of credit have led to fewer home equity loans being made, which has depressed consumer spending; businesses who rely on that spending have seen lower sales. All of these outcomes combine to depress state and local tax revenue. The ongoing and future regional and statewide impacts of rising defaults and foreclosures lend support to this Committee's decision to focus on what can and should be done to preserve homeownership among California's at-risk borrowers.

OPTIONS FOR AVOIDING DEFAULT AND FORECLOSURE

Once a borrower finds that he or she will be unable to make his or her minimum required monthly mortgage payment, the borrower has several options. Some options allow the borrower to retain possession of his or her home (retention options), while some involve sale of the home without the expense and stigma of foreclosure (non-retention options).

Retention Workout Options:

The simplest option is refinancing out of the unaffordable mortgage into a more affordable one. However, this option is increasingly unavailable to many subprime borrowers in today's tight credit markets.

Loan modifications involve making the loan more affordable for the borrower by modifying the loan contract in writing and permanently changing one or more of its original terms. Examples of changes that can be made include interest rate reductions, reductions in the outstanding principal balance, extensions of the loan term, establishment of escrows for taxes and insurance, or adding delinquent interest to the unpaid principal balance.

Forbearance involves an agreement by the lender or servicer to allow a reduced or suspended payment for a specific period of time. Under a policy of forbearance, the borrower still owes the unpaid amount, which may be folded into a repayment plan, or may ultimately be deferred or forgiven through a loan modification.

Non-Retention Options:

Borrowers with enough equity can sell their homes and pay off their mortgages in full.

Lenders and servicers can also agree to a short-sale, in which the institution agrees to accept the proceeds of a pre-foreclosure sale in satisfaction of the loan, even though the proceeds may be less than the amount owed on the mortgage.

Another alternative, often used when a property has been listed for a period of time with no interest among potential buyers, is a deed in lieu of foreclosure. A "deed in lieu" is a workout in which a borrower voluntarily conveys clear property title to the lender or servicer in exchange for a discharge of the debt.

Given today's depressed housing market, many borrowers are finding it impossible to refinance their mortgages to obtain more affordable terms. Furthermore, unless they purchased their home several years ago, few borrowers have the equity they would need to be able to sell the house and pay off their mortgage. In fact, many borrowers are upside down in their mortgages, a situation in which they owe more on their mortgages than their homes are worth.

Workout plans have become a subject of increased attention in 2007, as more and more borrowers find themselves unable to sell or refinance, and unable to afford their mortgage payments. The remainder of this background paper will focus on options available to lenders, servicers, and borrowers who wish to avoid default and foreclosure. The pages that follow will also discuss many of the challenges that face those who wish to accomplish a loan workout in lieu of foreclosure.

SECURITIZATION: A SOURCE OF COMPLEXITY

The retention workout options listed above are predicated on the assumption that the borrower contacts his or her institution before becoming seriously delinquent on his or her loan or that the lender reaches out to contact borrowers who have missed a payment or who the lender believes are likely to run into trouble upon an interest rate reset. The retention workout options listed above also assume that the institution which holds the loan is able to negotiate freely with the borrower to develop a workout option in the best interests of both. This latter assumption is valid when the originating lender retains the loan in its portfolio, but can be less accurate when the loan has been securitized, because the terms of the securitization governing documents may place restrictions on the servicer's flexibility to engage in loan modifications.

Historically, lenders made loans from their own funds and retained the loans in their portfolios. The originating lender would also service the loan (i.e., calculate the monthly payments due, collect them from the borrower, perform other administrative duties relative to the loan, and, if necessary, inform the borrower that he or she was behind on his or her payments).

In today's mortgage market, lenders often do not retain or service the loans they make to borrowers. More commonly, the originating lender funds the loan with a line of credit from a Wall Street investment bank or a commercial bank. Once the loan funds, the originator sells the loan to a bank or securities firm (usually the one from which it obtained its line of credit, but not always). The purchasing bank packages that loan with others into mortgage-backed securities (MBSs) it sells to institutional investors. In today's mortgage market, the servicing rights to a loan may be held by the originating lender or sold to a separate servicer. Today, several scenarios are possible – lenders may retain and service the loans they originate; lenders may sell some of the loans they originate into the securitized market and either retain the servicing rights on the securitized loans or sell the servicing rights to a separate institution; and lenders may purchase the servicing rights to loans made by other lenders. The decisions made by each lender are unique, and the mix of loans that are retained and serviced, only serviced, acquired from others, and sold varies by lender.

The system of securitization that has developed generally worked well in a rising housing market, by spreading loan risks among various investors and other market participants, and infusing a significant amount of capital into the mortgage markets, thereby expanding credit and homeownership opportunities. However, as the nonprime market has soured in recent months, widespread securitization of nonprime mortgage loans has generated a great deal of confusion among borrowers about who to contact if they find themselves in trouble making their payments and want to restructure their loans to improve their affordability. The existence of multiple parties to securitized loans can also make it difficult to discern the lines of responsibility among lenders, servicers, trustees, investors, and borrowers in some cases.

The lucrative business of packaging loans for sale to investors has evolved into a very large and important part of worldwide debt capital markets. The sheer size of the securitized mortgage market makes an understanding of its workings critical for understanding the challenges the securitized market poses to developing workout plans for borrowers in trouble.

The Size and Composition Of The Secondary Market For Mortgages

The MBS market is one of the largest financial markets in the world. As of June 30, 2006, MBSs accounted for the largest segment of the US bond market (23% of all outstanding bond market debt, compared to corporate bonds at 20% and Treasury debt at 16%).

According to the Mortgage Bankers Association, $1.2 trillion of privately-issued, residential mortgage-backed securities were issued in 2006. An additional $966 million worth of residential mortgage-backed securities were issued by Fannie Mae, Freddie Mac, and Ginnie Mae (collectively called the government-sponsored enterprises, or GSEs). Nonprime loans comprised two-thirds of private MBSs in 2005, up from 46% in 2003.

In the past few years, the growth of nonprime mortgages has changed the market for securities. As the nonprime market has grown, so has the popularity of private-label mortgage backed securities (i.e., those securitized by entities other than the GSEs). Total outstanding private-label MBSs represented 29% of all MBSs in 2005, more than double its share in 2003. At the same time, the share of MBSs held by the GSEs fell by 10 percentage points, from 53% to 43%. The shift is a dramatic reflection of investor choice. Investors left the guaranteed, GSE-backed mortgage market for higher interest rates in the potentially riskier, privately-backed mortgage securities market. As they did so, the amount of capital available to fund subprime loans grew, making more of these mortgages available to more borrowers. The amount of risk taken on by investors also grew, as we are seeing in today's volatile stock market.

How MBSs Work

MBSs represent an ownership interest in specified cashflows generated by a group of mortgage loans. The most basic mortgage securities, known as pass-throughs or participation certificates, represent a direct ownership interest in a pool of mortgage loans. These mortgage securities may be pooled again to create collateral for a more complex type of mortgage security, known as a collateralized mortgage obligation (CMO) or a real estate mortgage investment conduit (REMIC). CMOs and REMICs allow cash flows to be directed so that different classes of securities with different cashflow characteristics, maturities, and rates of return can be created.

Unlike other fixed-income securities, which return a stated rate of interest (the coupon rate) over the life of the bond and repay the face value of the bond upon its maturity, MBSs pay a coupon rate of interest and generate repayments of their principal over the life of the security. The cash flow generated by mortgage loans (and therefore MBSs) is irregular, because it is impossible to know ahead of time when an individual borrower will repay or refinance his or her loan. If homeowners whose loans are in a pool sell or refinance their homes, prepay their loans, or default, the principal is distributed on a pro-rata basis to investors in pass-though securities. Investors in CMOs and REMICs receive principal repayments according to the payment priorities of each CMO or REMIC and the class of securities they own. Most MBSs pay interest and principal on a monthly basis, although some pay quarterly or semiannually, depending on the terms of the issue. Because it can be difficult to predict the return on a pool of mortgage loans, their uncertainty has traditionally provided returns that exceed those of most other fixed-income securities of comparable quality.

The issuer and structure of each MBS largely determines its level of risk. Most pass-throughs are issued and/or guaranteed by one of the GSEs and carry an implied AAA credit rating. The remainder are privately issued and generally rated AAA or AA. Payments of principal and interest on pass-throughs are considered secure, but the cash flow on these investments can vary from month to month, depending on the actual prepayment rate of the underlying mortgages.

CMOs and REMICs are multi-class bonds backed by a pool of mortgage loans. In structuring a CMO or REMIC, an issuer distributes the cash flow from the underlying collateral over a series of risk classes called tranches. Each CMO or REMIC is a set of two or more tranches, each having an average life and cash-flow pattern designed to meet a specific investment objective. These bond issues can become quite complicated, and some have as many as 50 tranches.

As payments on the underlying mortgage loans are collected, the CMO or REMIC issuer typically first pays the coupon rate of interest to the bondholders in each tranche. As principal is received, it is distributed first to the investors in the first tranches; investors in later tranches do not start receiving principal payments until the prior tranches are paid off. Any principal remaining after the final tranche has been paid off is known as a residual. The residual can be traded as a stand-alone security. The concept of a residual has also come into play in the discussions (see sections below) over how workout plans on loans that are in a REMIC pool should be accounted for.

Investors in MBSs include institutions of all sizes -- corporations, commercial banks, life insurance companies, pension funds, trust funds, hedge funds, charitable endowments – as well as individuals. Virtually anyone can and does own a piece of America's mortgage market.

BARRIERS TO DEVELOPING WORKOUT PLANS

As noted earlier, developing a workout plan with a borrower is considerably more straightforward when the originating lender retains and services the loan than when the loan is held by investors and serviced by an institution that was not involved in making the original loan. However, even when a loan is not securitized, there can be barriers that complicate attempts to develop workouts. As many as six barriers to developing loan workouts have been identified.

Barriers That Apply Only To Securitized Loans

Limitations Imposed by Securitization Agreements

In June 2007, the American Securitization Forum (ASF) issued a Statement of Principles, Recommendations, and Guidelines for the Modification of Securitized Subprime Residential

Mortgage Loans. ASF, which is the umbrella group for over 350 organizations that are active participants in the US securitization market, issued the guidance in hopes of helping establish a common framework relating to the structure and interpretation of loan modification provisions in securitization transactions. The ultimate goal of ASF's efforts is to promote greater uniformity, clarity, and certainty to industry participants with respect to developing loan workouts with borrowers in trouble.

ASF's Statement is focused on modifications of first lien subprime residential mortgages, although ASF notes that most of the principles contained in its Statement could apply to modifications of other types of residential mortgage loans, as well. Much of the discussion below is based on the contents of ASF's Statement.

Generally speaking, the rules that apply to the servicing of subprime residential mortgage loans included in a securitization are governed by either a pooling and servicing agreement or by a servicing agreement. These agreements typically require the servicer to follow accepted servicing practices that it would employ "in its good faith business judgment" and which are "normal and usual in its general mortgage servicing activities," and/or certain procedures that the servicer would employ for loans held in its own portfolio. Some agreements also require that the servicer adhere to specific loss mitigation plans.

Most subprime securitizations authorize the servicer to modify loans that are either in default or for which default is either imminent or reasonably foreseeable. The "reasonably foreseeable" standard derives from, and is permitted by, the restrictions imposed by the REMIC sections of the Internal Revenue Code. According to ASF, most market participants interpret the two standards of future default (imminent and reasonably foreseeable) as substantially identical.

The modification provisions that govern loans deemed likely to default also require that the loan modifications be in the best interests of the securityholders (aka, the investors) or not materially adverse to the interests of the securityholders and, if the security is structured as a REMIC, that the modifications not result in a violation of the REMIC status of the securitization trust. Loan modifications that are generally acceptable under servicing agreements include changing the interest rate on a prospective basis, forgiving principal, capitalizing arrearages, and extending the maturity date of the loan. In additional to allowing servicers to modify loan terms, most subprime securitization agreements also permit other loss mitigation techniques, such as forbearance, repayment plans for arrearages, and other deferments that do not reduce the total amount owing. Securitization agreements also generally allow short sales.

A key interpretive challenge posed by most servicing and pooling and servicing agreements is a determination of which option (loan modification or foreclosure) is in the best interest of the securityholders. To make this determination, the servicer must evaluate which action is likely to produce the greatest recovery on the loan asset for securityholders – i.e., whether investors will be better served by modifying the terms of the loan or foreclosing on the related property. Clearly, the assumptions made are critical for determining whether a borrower receives a loan modification (and if so, what that modification looks like) or whether the borrower loses his or her home. The decision on whether the best interests of securityholders are being upheld is further complicated by the fact that different classes of securityholders (i.e., the holders of different tranches) may be affected differently by the same loan modification. ASF's guidance states that the "best interests of investors" standard is appropriately measured with reference to securityholders in the aggregate, rather than with respect to individual classes of securityholders. However, there is currently no guidance as to what assumptions are appropriate for use by servicers in determining whether a loan modification or a foreclosure will better serve the interests of investors. The task of developing reasonable assumptions is further complicated by the extreme volatility in today's mortgage, housing, and investment markets.

Most servicing and pooling and servicing agreements share several similarities relating to the ability of the servicer to work constructively with a borrower to avoid foreclosure. However, some servicing agreements impose specific limitations on workout plans, and these limitations can pose barriers that hamper servicers' ability to work constructively with borrowers. For example, some agreements limit the frequency with which a loan may be modified (e.g., no more than once in any 12-month period and no more than three times over the life of the loan). Other agreements provide a minimum interest rate below which a loan's rate cannot be changed. Other provisions may limit the total number of loans in the pool or in the tranche that may be modified (typically 5% when this provision is used) or may limit the total value of loans that may be modified (typically 5% of the initial size of the loan pool). Some agreements provide that if a loan modification eliminates or reduces a prepayment charge, the servicer must pay the amount of the prepayment charge that would have been due. Some agreements state that loan modifications cannot result in a denial of any primary mortgage insurance policy, or that the maturity date of the loan may not be extended beyond its initial date. Certain restrictions can be waived if approvals are given by mortgage insurers, credit rating agencies, or investors, but the nature of the individual servicing agreement governs the nature and number of approvals that are necessary.

Despite the barriers that appear to be posed by pooling and servicing agreements, ASF notes that these types of restrictions appear in only a minority of transactions. It does not appear that any securitization requires investor consent to a loan modification that is otherwise authorized under the operative documents.

Tax Implications of Restructuring Loans in a REMIC

As noted above, many securitizations are structured as REMICs. REMICs operate as pass-through entities for tax purposes. As such, their gains and losses are passed through to the REMIC's holders; the REMIC is not taxed at the entity level. If a securitized pool of loans were to lose its REMIC status, the tax implications for investors could be significant.

The REMIC portion of the tax code generally provides that in order to be modified, a loan must either be in default or reasonably foreseeable default, or that the modification not be significant, as that term is defined under the REMIC code. As discussed earlier, servicing agreements and pooling and servicing agreements also generally require that the modifications be in the best interests of the security holders or not materially adverse to the interests of the securityholders, and that the modifications not result in a violation of the REMIC status of the securitization trust. To date, the IRS has not issued any guidance on which types of loan modifications are allowable and consistent with the REMIC portions of the IRC and which, if any, would disqualify a pool from REMIC status. There is also no specific IRS guidance on what steps a servicer must take to determine whether default is reasonably foreseeable.

Accounting Challenges Posed By Loan Restructuring

Earlier this year, some servicers questioned whether they would be at risk of violating Financial Accounting Standard (FAS) 140 by modifying securitized loans held in trusts, in order to prevent those loans from going into default. FAS 140 governs "qualifying special-purpose entities." These entities qualify for off-balance-sheet treatment (i.e., the holders of these entities do not have to account for them in the same way they account for other assets and liabilities). Qualifying special purpose entities are supposed to operate passively, under changes adopted after the Enron scandal. The question held by servicers earlier this year was whether loan modifications would disqualify securitized loans from the special accounting treatment for which they are currently eligible. Although servicing and pooling and servicing agreements allow servicers to modify loans in default or for which default is imminent or reasonably foreseeable, many in the industry feared that such modifications would "blow their Q status" under FAS 140 and force them to account for loans they did not own.

In June 2007, House Financial Services Committee Chairman Barney Frank, together with nine Financial Services Committee members, sent a letter to the Securities and Exchange Commission (SEC) asking for clarity in this area. The Congressmen asked, "Does FAS 140 clearly address whether a loan held in a trust can be modified when default is reasonably foreseeable or only once a delinquency or default has already occurred? If not, can it be clarified in a way that will benefit both borrowers and investors?"

In July 2007, SEC Chairman Christopher Cox responded with a letter stating that loan servicers can use their discretion to alter securitized mortgages that may be nearing foreclosure, without affecting the "Q" status of the loans. In his letter, Cox wrote, "The commission's professional staff believes that, consistent with general agreement in practice, such loan modifications would not result in a requirement for entities to account for those securitized assets on their balance sheet."

Barriers That Apply To All Loans, Whether or Not Securitized

Tax Implications of Forgiven Debt

Under both federal and California tax law, any borrower debt that is forgiven by a lender or a servicer is taxable to the borrower as ordinary income in the year in which the debt is forgiven. For example, if $50,000 in principal of a $450,000 mortgage is written off by the lender as part of a workout plan or a short sale, the borrower would have to increase his or her adjusted gross income by $50,000 that year. These tax law implications reduce the ultimate financial benefit realized by a borrower from a workout arrangement that involves the forgiveness of principal.

The tax law treatment of forgiven interest is less clear. The tax code specifies that discharge of indebtedness is taxable, but does not specify that the discharge of an *obligation* (such as interest) is taxable. According to representatives of the Franchise Tax Board (FTB), the IRS has not issued any guidance on whether taxpayers who have some portion of their interest payments forgiven by their mortgage holder should treat that forgiven interest as taxable income. Because California conforms to federal law in this area, any decision by the IRS regarding treatment of forgiven interest would be followed by California. On the basis of a preliminary review of the issue, FTB legal staff believes that forgiven interest would not be taxable to the borrower. If this interpretation is correct, it could mean that mortgage workout plans that forgive interest are more beneficial to borrowers in the short-term than those that forgive principal. However, FTB's interpretation is preliminary and non-binding; a final ruling on the matter will have to come from the IRS.

Ability of Lenders and Servicers to Retool Their Operations

Up until very recently, the mortgage industry was based upon a sales model. The objective was to solicit borrowers, sell them loans, package those loans for sale on the secondary market, and service the loans for a fee. In a rising real estate market, everyone in the real estate business made money, and borrowers could easily refinance out of mortgages whose rates reset to levels they could no longer afford. The system was set up to sell mortgages, process payments, and refinance borrowers; few in the mortgage industry were set up to handle borrowers unable to make their payments.

As borrowers began having trouble making their payments, many found their lenders and servicers unprepared to respond. These mortgage professionals had sales forces; they did not generally employ large numbers of people trained to work with borrowers to help identify strategies for helping them remain in their homes. It takes time for a large lender or servicer to retool its operations, train its phone operators to identify borrowers who should be directed to loan workout sections, train other employees to work with borrowers who contact the lender seeking loan modifications, readjust its underwriting guidelines to evaluate which borrowers will receive loan workouts, and create a menu of acceptable loan modifications. Anecdotally, these changes are occurring slowly, and some borrowers who contact their lenders seeking help are not being directed to people able to help them.

Some who are familiar with the inability of lenders and servicers to be responsive to all borrowers' needs have questioned the desire of lenders and servicers to work with borrowers to help avoid foreclosure. Although the motivation of each loan holder to pursue workouts will vary depending on the institution, most institutions have a variety of reasons for wanting to work with borrowers. In June 2007, the OCC issued a briefing paper titled, "Foreclosure Prevention: Improving Contact with Borrowers." In that brief, the OCC cited four reasons why loan servicers would want to help avoid foreclosure. Among these reasons:

> Reputation risk: Lenders face negative publicity over rising foreclosure rates in general, as well as over their institution's specific foreclosure rates. When a significant number of loans made by a lender and packaged in an investment pool go into default, the secondary market can develop concerns about all loans originated by that institution. These defaults can negatively affect the institution's ability to sell new loans in the secondary market. An institution's reputation among the rating agencies may also be negatively affected.

Costs to Lenders' Internal Portfolios: If loans are held in a lender's portfolio (i.e., not sold to others), foreclosures can result in direct losses by the institution. A bank that forecloses on a home must absorb the cost to maintain and resell the property, and often loses a significant amount of money in the process. Vacant and abandoned properties are vulnerable to vandalism, deterioration, and criminal activities. Furthermore, housing prices are depressed in areas with large numbers of foreclosures. All of these factors combine to increase the cost of holding onto the home and to decrease the ultimate sales price. According to the OCC, lenders currently receive 40 to 80 cents on the dollar on homes on which they foreclose.

Costs of Servicing: As a delinquency progresses, most servicers make advances for taxes, insurance, property preservation, inspections, and legal costs. Servicers must also make advances on principal and interest to investors, regardless of whether the servicer has received a payment from the borrower. Many, but not all, of those advances are reimbursed once the property is liquidated, but the servicer still faces the cost of advancing these funds. Estimates suggest that servicing a loan in foreclosure is three times more costly than servicing a current loan.

Community Reinvestment Act (CRA) Credit: The OCC notes that two activities useful for preventing foreclosure can qualify a bank for favorable CRA credit. First, banks can provide financial counseling to low- or moderate-income borrowers, either directly or through a nonprofit agency. Second, banks can refinance higher, variable rate mortgages into lower, fixed-rate mortgages for low- or moderate-income borrowers. OCC examiners will consider either of these activities as responsive to helping meet the credit needs of a community.

Willingness of Borrowers to Step Forward

Although listed last, this barrier is perhaps the most important of all six to overcome. It has been well-documented by consumer groups, counseling organizations, and regulators that early contact with borrowers in trouble is the most effective way to help them avoid default and foreclosure. Yet, it has also been documented that many borrowers are extremely reluctant to come forward and contact their mortgage holder about trouble they are having, or are about to have, making their payments. The Housing Policy Council of the Financial Services Roundtable recently reported that at least half of all borrowers whose homes went into foreclosure never spoke to their servicer.

According to the OCC report referenced above, the following reasons were cited by borrowers for avoiding contact with their loan holders (in decreasing order of frequency): 1) the borrower did not know the lender might be helpful; 2) the borrower assumed that he or she would be able to make the required payment in a few days; 3) the borrower did not think the lender would care; 4) the borrower was afraid the lender would foreclose on the house; 5) the borrower was embarrassed to talk about his or her problems; and 6) the borrower was afraid the lender would charge a penalty or fee.

Some lenders and servicers are employing the assistance of nonprofit credit counseling agencies to perform the initial contact with the borrower, in hopes that counseling agencies are more trusted by borrowers and that borrowers may be more likely to respond to a call or a letter from a counseling agency. Several reputable nonprofit organizations have also partnered with mortgage servicers to provide no-cost telephone counseling to delinquent borrowers.

SOME EXAMPLES OF WHAT IS BEING DONE

The examples below are intended to be illustrative, rather than all-inclusive. Several of the witnesses that will appear before the Committee on August 21st will expand upon the discussions below to provide more information about ongoing outreach efforts.

Actions By Counseling Organizations

NeighborWorks America is a national nonprofit organization created and funded by Congress to provide financial support, technical assistance, and training for community-based revitalization efforts. In response to rising foreclosures, NeighborWorks created a Center for Foreclosure Solutions. Working with national nonprofit, mortgage, and insurance partners, the Center builds capacity among foreclosure counselors around the nation, conducts public outreach campaigns to reach struggling homeowners, and researches local and national trends to develop strategic solutions. In cities and states with high rates of foreclosure, the Center works with local leaders to create sustainable foreclosure intervention programs.

In 2006, NeighborWorks America partnered with the Homeownership Preservation Foundation to create a hotline open 24 hours a day, 7 days a week. The toll-free hotline, which is manned by over 100 English- and Spanish-speaking counselors, is called the HOPE hotline and can be reached at 1-888-995-HOPE. Depending on the nature of a caller's problem, counseling can be provided as part of the initial call, or through a series of follow-up calls, or in-person visits to a local counseling agency close to where the borrower is located. HOPE hotline operators also have the phone numbers for loan modification departments at each of the country's major lenders and servicers; in this way, they can help put borrowers in need directly in touch with the people at those institutions who are best suited to help them. The HOPE hotline received over 25,000 calls from troubled homeowners during 2006 and was able to develop an actionable workout plan to help 42% of those callers avoid foreclosure.

In recognition of the fact that few borrowers realize there is help available, the Center for Foreclosure Solutions recently launched a Foreclosure Prevention Advertising Campaign in partnership with the Ad Council. The campaign seeks to decrease foreclosures by directing struggling borrowers to call the HOPE hotline, where they will receive counseling and be connected, as appropriate, with their lender or local NeighborWorks organization. According to NeighborWorks, the tone and manner of the advertisements will be hopeful, straight forward, empathetic, realistic, and affirming, and will include TV, radio, newspaper, magazine, web and outdoor advertising. The campaign launched nationally in June 2007, with a special focus on areas with high rates of foreclosure.

No Homeowner Left Behind

In Fresno, California, an area that has been hard hit by foreclosures, real estate professionals, counseling organizations, regulators, and financial institutions have partnered to form an organization titled No Homeowner Left Behind (NHLB). The mission of the organization, which runs a local foreclosure prevention hotline, is to ensure that homeowners have access to timely, accurate, unbiased information and reputable professionals to help them preserve home ownership when feasible, and to minimize loss of equity and other adverse impacts when home retention is not possible. More information about the group can be found at www.nohomeownerleftbehind.org. NHLB believes that its partnership model can be used by other jurisdictions in California that want to reach out to borrowers facing foreclosure.

Actions By Federal Regulators

Statement on Working with Borrowers

In April 2007, OCC, the Federal Reserve Board (FRB), Office of Thrift Supervision (OTS), Federal Deposit Insurance Corporation (FDIC), and National Credit Union Administration released a "Statement on Working with Mortgage Borrowers." In that statement, the five federal regulatory agencies encouraged financial institutions to work constructively with residential borrowers who are financially unable to make their contractual payment options on their home loans. According to the Statement, "Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower."

The Statement encourages financial institutions to consider prudent workout arrangements that increase the potential for financially stressed residential borrowers to keep their homes, but acknowledges that there may be instances when workout arrangements are not economically feasible or appropriate. Financial institutions should follow prudent underwriting practices in determining whether to consider a workout arrangement. The Statement notes that the regulatory agencies will not penalize financial institutions that pursue reasonable workout arrangements with borrowers who have encountered financial problems.

The Statement also notes that financial institutions can receive favorable CRA consideration for programs that transition low- and moderate-income borrowers from higher-cost to lower-cost loans, provided the loans are made in a safe and sound manner. The Statement references the Center for Foreclosure Solutions sponsored by NeighborWorks as one example of a reputable organization with which financial institutions can work to help avoid foreclosures through credit counseling.

The Statement concludes by reminding financial institutions that the Homeownership Counseling Act requires them to inform certain borrowers who are delinquent on their mortgage loans about the availability of homeownership counseling and notes that the Department of Housing and Urban Development maintains a list of approved counselors.

FDIC's Partnership with NeighborWorks

In July 2007, the FDIC announced a partnership with NeighborWorks America to expand foreclosure prevention efforts in nine markets nationwide. Los Angeles was included as one of the nine initial focus areas. The program matches NeighborWorks borrower counseling efforts with the FDIC's Alliance for Economic Inclusion, which includes bankers, community organizations, and other local advocates involved in developing projects to help the underbanked.

Federal Reserve Bank of San Francisco's Regional Forums

In May and June 2007, the Federal Reserve Bank of San Francisco, together the FDIC, OCC, and OTS, held a series of regional forums in parts of California, Arizona, and Nevada that have been hard-hit by defaults and foreclosures. Although none of the information related to these forums had been made public at the time this background paper was prepared, Federal Reserve Bank staff plan to make the details of the forums public in the near future. Federal Reserve Bank staff indicate that the forums were very similar in focus to this Committee's upcoming informational hearing. The Federal Reserve Bank of San Francisco plans to use the results of their forums to structure outreach efforts aimed at helping reduce defaults and foreclosures among at-risk borrowers.

Actions By State Regulators

In May 2007, the Business, Transportation, & Housing Agency (BT&H) launched the yourhome.ca.gov and sucasa.ca.gov web sites, intended to serve as clearinghouses of information for California consumers looking for information about how to obtain a mortgage or where to get help with an existing mortgage. The web sites provide links to a variety of public and private resources, such as web pages for Cal HFA, the California Departments of Financial Institutions, Corporations, and Real Estate (DFI, DOC, and DRE), Fannie Mae, Freddie Mac, the U.S. Department of Housing and Urban Development, FDIC, and the U.S. Department of Veterans Affairs.

The Department of Consumer Affairs (DCA), in cooperation with BT&H, has also hosted several regional town hall forums intended to reach out to troubled borrowers and offer to link them with housing counselors, real estate professionals, and regulators who can help them. Many of the forums have been attended by representatives from DFI, DOC, and DRE, as well as representatives of major financial institutions. DCA has also developed a mortgage town hall template for use by Assemblymembers and Senators who wish to hold their own mortgage town hall forums.

WHAT MORE COULD BE DONE

Some states, such as New York and Ohio, have plans to sell taxable bonds to raise money for funds to help low- and moderate-income borrowers refinance into more affordable loan products. Some consumer advocacy organizations are urging six-month to one-year moratoriums on residential mortgage foreclosures. Others are encouraging lenders and investment banks to fund anti-foreclosure efforts. Fannie Mae is seeking a 10% increase in its $727 billion portfolio cap to buy additional mortgages, hoping to alleviate the ongoing credit crunch in the markets and bring an additional measure of stability. The consumer advocates invited to testify on August 21st will expand upon these ideas, and offer more.

CONCLUSION

One of the primary goals of this Committee's informational hearing is gaining an understanding of which strategies have been found most effective for helping identify borrowers in trouble, and working with these borrowers to develop strategies that – optimally – result in positive outcomes for the borrowers, the investors or lenders who hold their loans, and the servicers who administer their loans.

The literature reviewed by Committee staff suggests that early contact with borrowers who are in trouble or who are likely to encounter difficulties in making their mortgage payments is critical. Identifying who is likely to run into payment trouble in time to offer them an affordable workout plan can help prevent loans from going into default. Reaching out to borrowers and convincing them to come forward at the first signs of trouble can also help avoid default. Providing counseling to borrowers who find themselves unable to make their payments can help identify ways they can either keep their homes, or, if home retention is impossible, can identify ways in which they can avoid trouble with other creditors and, ultimately, can help prevent personal bankruptcy.

Once troubled borrowers have been identified and are in contact with their lenders or servicers, these institutions must be prepared to evaluate which borrowers can be helped, and how. The pages above summarize several barriers to developing workout plans for borrowers. All of the barriers appear to be surmountable, provided that the lender/servicer, the investor(s), and the borrower are motivated to work things out. If lenders or investors decide that foreclosure is preferable to restructuring a loan, they are legally able to force people out of their homes. California's economy could take a significant hit if large numbers of institutions and investors make that decision.

Even if investors and institutions recognize the value of homeownership preservation and opt to restructure large number of home loans, they could run into challenges. One of the problems likely to exacerbate attempts to refinance troubled borrowers into new loans is the credit crunch now gripping Wall Street. News stories abound of lenders restricting credit for consumers and corporations, investors expressing concern over the levels of risk in their portfolios, lenders halting mortgage lending operations and raising interest rates on certain types of loans, and bearish speculators sending the stock market lower and lower. Amid the turmoil, it is likely to be extremely difficult for borrowers whose credit is already shaky to obtain new loans.

The ultimate answers will likely be played out over the next eighteen months, as large numbers of mortgage interest rates reset at a time in which many predict the stock market to remain extremely volatile.

SECTION THREE

WRITTEN TESTIMONY AND OTHER WRITTEN MATERIALS SUBMITTED BY WITNESSES

LAO

65 YEARS OF SERVICE

August 21, 2007

The Subprime Mortgage Situation

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Banking, Finance and Insurance Committee

LAO 65 YEARS OF SERVICE

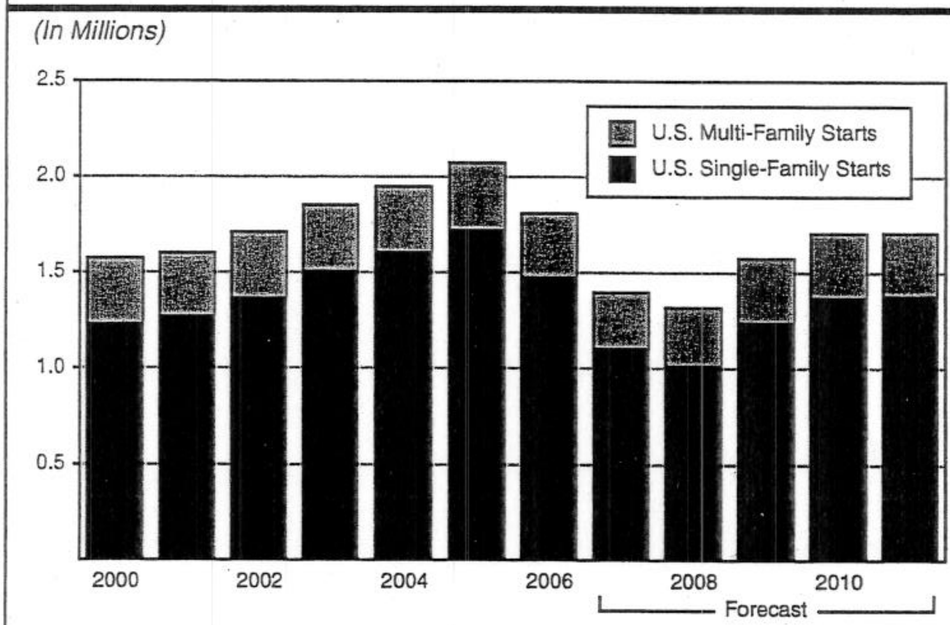
The Current Situation in the Financial Markets

- ☑ In recent years, the financial markets have created many new products. Some of these developments increased the risks associated with certain types of investments and lending.
- ☑ In mortgage lending, one result was an expansion of lending to home purchasers with relatively high default risks.
- ☑ For example, there were increases in mortgage loans offered with low or no down payments, reduced front-end interest rates that reset at higher levels within a few years, and more lax income reporting requirements.
- ☑ Last year, the mortgage market started experiencing increased loan late payments, loan delinquencies, and loan foreclosures. Contributing factors included:
  - Increases in borrowers' monthly payments due to resetting variable rate loans.
  - Reductions in home values in some markets, which prevented some borrowers from refinancing their loans.
- ☑ Initially, the problem with defaults appeared to be confined to the high-risk segment of the mortgage lending market.
- ☑ More recently, however, other financial markets have also been affected, as investors have reassessed risk in markets such as less-risky mortgage products, corporate junk bonds, and leveraged buyouts.
- ☑ At present, the financial markets are still in flux. It is unclear exactly what types of adjustments will be occurring over the weeks and months to follow.

LAO
65 YEARS OF SERVICE

How Has the Housing Market Been Impacted?

Housing Starts



☑ ***Housing Has Been Hit Hard.*** For the nation:

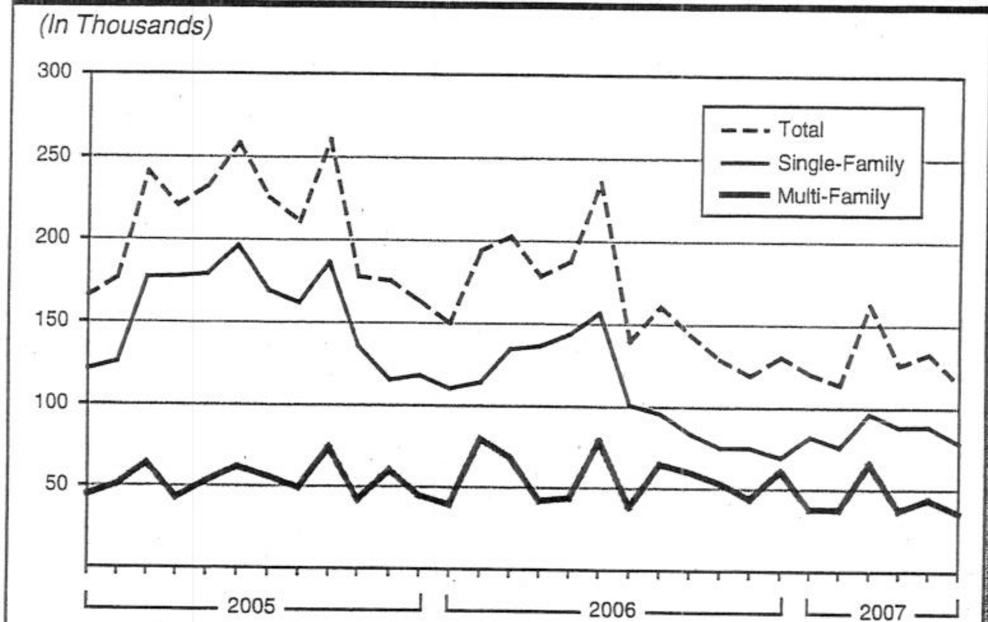
- U.S. housing starts fell to a ten-year low in July and are down by over 20 percent in the past year. For all of 2007, starts are expected to total only 1.4 million units, lowest in many years.
- Prices have also softened and unsold inventories are up.
- The hit on single-family homes has been greatest.
- Many forecasters now expect the beginning of the housing recovery to be delayed until the first half of 2008.

☑ ***Regional and State Impacts Vary.*** Although these impacts have been felt nationwide, some state and regional markets are in much worse shape than others, reflecting the more extreme speculative activity that occurred there in past years. Many of California's markets fall into this category.

LAO 65 YEARS OF SERVICE

How Is California's Housing Market Doing?

New Housing Permits



- ☑ ***Permits Are Way Down.*** As shown above, housing permits in the state fell to an annual rate of only 114,000 in June 2007.

- ☑ ***Prices Are Soft, Although Somewhat Sticky.*** In June 2007, the median sales price of a single-family home in the state was reported to be $594,000, down cnly a bit from the record of $597,000 set in April 2007.

- ☑ ***But Further Price Declines Could Occur.*** However, the fact that sales are down and inventories are up indicates that many unsold homes have doubtless decreased in value and are either being kept off the market or not able to be sold for their asking prices.

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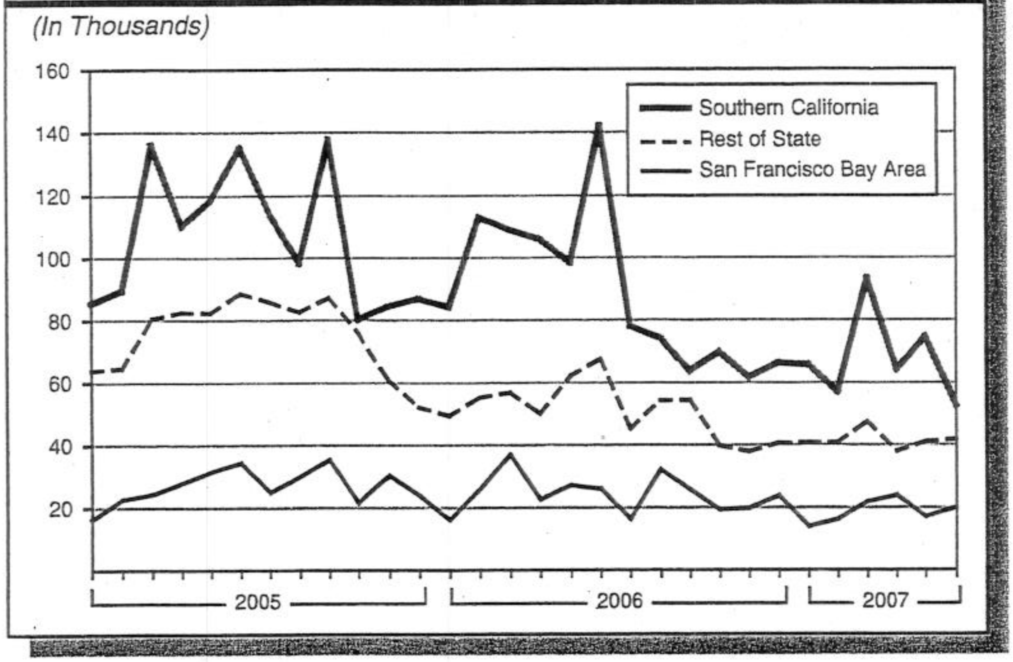
How Have Different Areas In the State Performed?

New Housing Permits



☑ ***Southern California Has Been the Weakest Region.*** New building permits in Southern California amounted to only about 53,000 in June 2007, down significantly from earlier months.

☑ ***Permits in Other Geographic Areas—Relatively Flat.*** Combined, new housing permits in the remainder of the state, while soft, have been fairly flat in recent months.

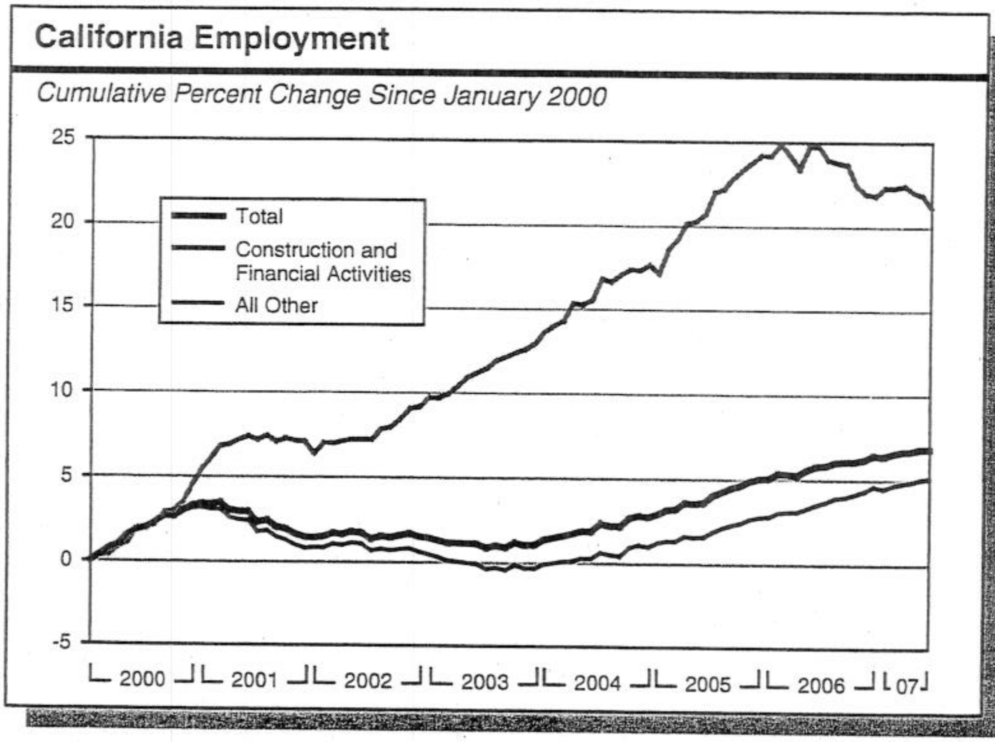
☑ ***What About Geographic Price Variation?*** Here, too, considerable variation exists:

- Some very desirable areas are continuing to report rising median prices; Contra Costa County, for example, saw its June 2007 median sales price rise to a new high of $905,000.

- However, price softness is present in many areas of California, and in some, significant declines are occurring.

LAO 65 YEARS OF SERVICE

How Has the Overall Economy Been Affected?



- ***Economy Still Expanding.*** Despite some slowing, the overall U.S. economy is continuing to experience modest growth.

- ***But the Pace of Growth Has Been Trimmed.*** Consumer spending nationally, while robust in the first quarter of 2007, grew at just a 1.4 percent annual rate in the second quarter. As least some of this slowdown appears due to the housing downturn.

- ***What About Economic Effects in California?*** Here, too, the economy is still expanding. Statewide employment has been clearly hurt in the areas of construction and financial services (many of which are related to real estate). However, job growth has continued to occur in the rest of the economy, although the pace has only been modest. Likewise, sales tax revenues are thus far meeting estimates, suggesting consumer spending in the state is holding up.

LAO
65 YEARS OF SERVICE

Implications and Outlook

- ☑ The full implications of the mortgage market's problems, both nationally and for California, are still unfolding and will not be known for some time.

- ☑ The slowdown in the housing market has been apparent for a while. Both the LAO and the Department of Finance did incorporate a slowdown in the housing sector in their recent state economic and revenue forecasts.

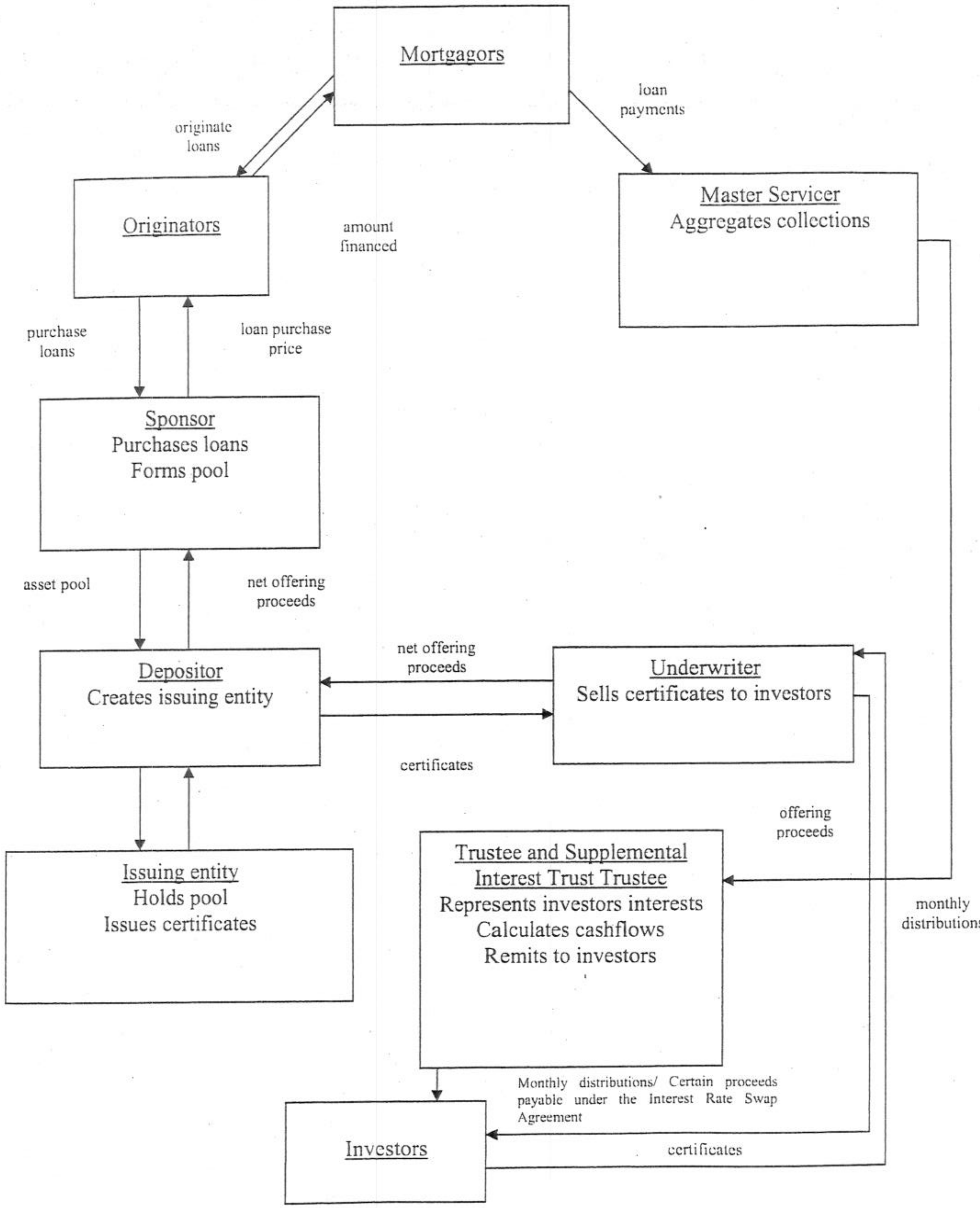
- ☑ There is, however, some evidence suggesting that the magnitude of the housing slowdown may be greater than previously thought and that the troubles in the mortgage market may affect other segments of the financial markets and economy.

- ☑ Thus far, however, many other sectors of the economy remain fairly strong.

- ☑ While the current turmoil in the mortgage market is producing a drag on the economy in the short run, and requiring painful adjustments in many areas, most economists believe these types of corrections are necessary for the long-run health of the economy.

Source: American Securitization Forum

TYPICAL TRANSACTION STRUCTURE



American Securitization Forum

Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans

June 2007

I. Introduction

The American Securitization Forum (ASF)[1] is publishing this Statement as part of its overall efforts to inform its members and promulgate relevant securitization industry guidance in light of the widespread challenges currently confronting the subprime residential mortgage markets.

Current subprime residential mortgage market conditions include a number of attributes of concern that impact securitization transactions and the broader environment for subprime mortgage finance: an increase in delinquency, default and foreclosure rates; a decline in home price appreciation rates; a prevalence of loans with a reduced introductory rate that will soon adjust to a higher rate; and a reduced availability of subprime mortgage lending for refinancing purposes. In light of these concerns, the ASF is of the view that loan modifications, for subprime mortgage loans that are in default or for which default is reasonably foreseeable, are an important servicing tool that can both help borrowers avoid foreclosure and minimize losses to securitization investors.

Moreover, the ASF recognizes that it is an important goal to minimize foreclosure and preserve homeownership wherever possible. Higher than normal rates of foreclosure may harm borrowers and their communities, and may adversely affect housing values and therefore collateral values on both performing and non-performing loans. Accordingly, the ASF recommends the use of loan modifications under appropriate circumstances as described in this Statement.

The overall purpose of this Statement is to provide guidance for servicers modifying subprime residential mortgage loans that are included in a securitization. It is our hope that publication of these principles, recommendations and guidelines will help to establish a

[1] The American Securitization Forum is a broad-based professional forum of over 350 organizations that are active participants in the U.S. securitization market. Among other roles, ASF members act as insurers, investors, financial intermediaries and professional advisers working on securitization transactions. ASF's mission includes building consensus, pursuing advocacy and delivering education on behalf of the securitization markets and its participants. This statement was developed principally in consultation with ASF's Subprime Mortgage Finance Task Force and Loan Modifications Working Group, with input from other ASF members and committees. Additional information about the ASF, its members and activities may be found at ASF's internet website, located at www.americansecuritization.com. ASF is an independent, adjunct forum of the Securities Industry and Financial Markets Association.

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common framework relating to the structure and interpretation of loan modification provisions in securitization transactions, thereby promoting greater uniformity, clarity and certainty of application of these provisions throughout the industry. As a consequence, ASF hopes that this guidance will facilitate wider and more effective use of loan modifications in appropriate circumstances.

While this Statement addresses certain legal, regulatory and accounting matters, it does not constitute and should not be viewed as providing legal or accounting advice.

This Statement is focused on modifications of first lien subprime residential mortgage loans. Many of the principles reflected in this Statement would also apply to modifications of other types of residential mortgage loans. This Statement does not address modifications of second lien residential mortgage loans.

II. Overview of Typical Securitization Document Modification Provisions

Servicing of subprime residential mortgage loans included in a securitization is generally governed by either a pooling and servicing agreement or servicing agreement. These agreements typically employ a general servicing practice standard. Typical provisions require the related servicer to follow accepted servicing practices and procedures as it would employ "in its good faith business judgment" and which are "normal and usual in its general mortgage servicing activities" and/or certain procedures that such servicer would employ for loans held for its own account.

Most subprime transactions authorize the servicer to modify loans that are either in default, or for which default is either imminent or reasonably foreseeable. Generally, permitted modifications include changing the interest rate on a prospective basis, forgiving principal, capitalizing arrearages, and extending the maturity date. The "reasonably foreseeable" default standard derives from and is permitted by the restrictions imposed by the REMIC sections of the Internal Revenue Code of 1986 (the "REMIC Code") on modifying loans included in a securitization for which a REMIC election is made. Most market participants interpret the two standards of future default – imminent and reasonably foreseeable – to be substantially the same.

The modification provisions that govern loans that are in default or reasonably foreseeable default typically also require that the modifications be in the best interests of the securityholders or not materially adverse to the interests of the securityholders, and that the modifications not result in a violation of the REMIC status of the securitization trust.

In addition to the authority to modify the loan terms, most subprime pooling and servicing agreements and servicing agreements permit other loss mitigation techniques, including forbearance, repayment plans for arrearages and other deferments which do not reduce the total amount owing but extend the time for payment. In addition, these agreements typically permit loss mitigation through non-foreclosure alternatives to terminating a loan, such as short sales and short payoffs.

Beyond the general provisions described above, numerous variations exist with respect to loan modification provisions. Some agreement provisions are very broad and do not have any limitations or specific types of modifications mentioned. Other provisions specify certain types of permitted modifications and/or impose certain limitations or qualifications on the ability to modify loans. For example, some agreement provisions limit the frequency with which any given loan may be modified. In some cases, there is a minimum interest rate below which a loan's rate cannot be modified. Other agreement provisions may limit the total number of loans that may be modified to a specified percentage (typically, 5% where this provision is used) of the initial pool aggregate balance. For agreements that have this provision: i) in most cases the 5% cap can be waived if consent of the NIM insurer (or other credit enhancer) is obtained, ii) in a few cases the 5% cap can be waived with the consent of the rating agencies, and iii) in all other cases, in order to waive the 5% cap, consent of the rating agencies and/or investors would be required. It appears that these types of restrictions appear only in a minority of transactions. It does not appear that any securitization requires investor consent to a loan modification that is otherwise authorized under the operative documents.

III. Loan Modification Principles

Based upon extensive consultation with its members and other securitization market participants, ASF believes that the following principles articulate widely-accepted industry views regarding the use of loan modifications in connection with securitized subprime residential mortgage loans:

1. For subprime mortgage loans that are in default or where default is reasonably foreseeable, loan modifications are an important loss mitigation tool that should be used in the circumstances described in this Statement. Modifications may include changing the interest rate on a prospective basis, forgiving principal, capitalizing arrearages and extending the maturity date. Other loss mitigation alternatives include forbearance, repayment plans for arrearages and other deferments which do not reduce the total amount owing, and also non-foreclosure alternatives to terminating a loan, such as short sales and short payoffs. Unlike other loss mitigation alternatives, loan modifications have the additional advantage that they can be used prior to default, where default is reasonably foreseeable.

2. Establishing early contact with borrowers is a critically important factor in the success of any loss mitigation initiative. Servicers should be permitted and encouraged to reach out affirmatively and proactively to borrowers for whom default is more likely, determine whether default is reasonably foreseeable, and

then explore modification possibilities. In particular, such outreach should be permitted and encouraged prior to an upcoming first adjustment date on a hybrid ARM loan.

3. Loan modifications should be considered and made on a loan-by-loan basis, taking into account the unique combination of circumstances for each loan and borrower, including the borrower's current ability to pay. The ASF is opposed to any across-the-board approach to loan modifications, and to any approach that would have all modifications structured in a particular manner. The ASF is also opposed to any proposals that would provide an across-the-board moratorium or delay period on foreclosures.

4. Generally, the ASF believes that loan modifications should only be made:

   a. Consistently with applicable securitization operative documents (including amendments that can be made without investor or other consents);

   b. In a manner that is in the best interests of the securitization investors in the aggregate;

   c. In a manner that is in the best interests of the borrower;

   d. In a manner that, insofar as possible, avoids materially adverse tax or accounting consequences to the servicer and, to the extent known, to the securitization sponsor or investors;

   e. Where the loan is either in default or default is reasonably foreseeable, and if the latter, where there is a reasonable basis for the servicer determining that the borrower is unlikely to be able to make scheduled payments on the loan in the foreseeable future;

   f. Where there is a reasonable basis for the servicer concluding that the borrower will be able to make the scheduled payments as modified; and

   g. In a manner that is designed to provide sustainable and long-term solutions, but does not reduce the required payments beyond the magnitude required to return the loan to performing status, or beyond the anticipated period of borrower need.

5. The ASF believes that loan modifications meeting the criteria in Loan Modification Principles point 4 above are generally preferable to foreclosure where the servicer concludes that the net present value of the payments on the loan as modified is likely to be greater than the anticipated net recovery that would result from foreclosure.

6. In considering loss mitigation alternatives that reduce the interest rate prospectively, servicers should consider whether to make the rate reduction temporary (such as a relatively short term extension of the initial fixed period on a hybrid ARM), or permanent, based on the anticipated period of borrower need. For temporary rate reductions, servicers should re-evaluate the borrower's ability to pay, and the continued need for a rate reduction, at the end of the temporary period.

7. Any loan modification that reduces otherwise lawful, contractually required payments of principal or interest must be understood to be a financial concession by the securitization investors. There is no basis for requiring such concessions from investors unless the modification is determined to be in the best interests of the investors collectively. Loan modifications should seek to preserve the originally required contractual payments as far as possible.

8. Reasonable determinations made by servicers with respect to loan modifications, where made in good faith and in accordance with generally applicable servicing standards and the applicable securitization operative documents, should not expose the servicer to liability to investors and should not be subject to regulatory or enforcement actions.

IV. Loan Modification Interpretive Guidance

The ASF endorses the following interpretive positions on specific issues arising in connection with loan modifications:

1. The ASF believes, based on prevailing existing practice, that standard and customary servicing procedures for servicing subprime mortgage loans included in a securitization, as typically used as an overarching servicing standard in securitization operative documents, should be interpreted to allow the servicer to: a) permit loan modifications (including prospective interest rate reductions which may be either temporary or permanent, forgiveness of principal, capitalizing arrearages, or maturity extension not beyond the securitization maturity date) for loans that are in default or for which default is reasonably foreseeable, so long as the modification is in the best interests of investors in the aggregate, and b) engage in other loss mitigation alternatives including forbearance, repayment plans for arrearages and other deferments which do not reduce the total amount owing, and also non-foreclosure alternatives to terminating a loan, such as short sales and short payoffs. The ASF believes that existing securitization pooling and servicing agreements should be interpreted, to the maximum extent possible, to authorize the servicer to take the actions referenced above.

2. With respect to existing pooling and servicing or other operative agreements that expressly prohibit or restrict the servicer from taking the actions referenced above, the ASF believes that amendments to those agreements authorizing such actions should be approved by all parties required to consent to such amendments, as and when requested to do so.

3. The ASF believes that securitization operative documents should not impose numerical limitations on loan modifications, such as limits based on the percentage of the pool that may be modified.

4. The modification standards "default is imminent" and "default is reasonably foreseeable" should be interpreted to have the same meaning.

5. The modification standard "default is reasonably foreseeable" should be deemed to be met where there has been direct contact between the servicer and the borrower, where the servicer has evaluated the current ability to pay of the borrower, and has a reasonable basis for determining that the borrower is unlikely to be able to make scheduled payments on the loan in the foreseeable future. (This interpretation is intended to provide guidance only as to a set of circumstances where the standard would generally be viewed to be met, and not to reflect any view that the standard would not be met in other circumstances.)

6. In evaluating whether a proposed loan modification will maximize recoveries to the investors, the servicer should compare the anticipated recovery under the loan modification to the anticipated recovery through foreclosure on a net present value basis. Whichever action is determined by the servicer to maximize recovery should be deemed to be in the best interests of the investors.

7. The standards "in the best interests of" or "not materially adverse to the interests of" investors or securityholders in any securitization should be interpreted by reference to the investors in that securitization in the aggregate, without regard to the specific impact on any particular class of investors, and in a manner that is neutral as to the effect on the cash flow waterfall or any particular class of securities.

V. Loan Modification Recommendations

The ASF recommends the following further actions in respect of loan modifications:

A. Existing and future securitizations:

1. The ASF endorses and encourages the adoption of the position articulated in the Mortgage Bankers Association position paper titled "FAS 140

Implications of Restructurings of Certain Securitized Mortgage Loans", dated May [24], 2007 (the "MBA Position Paper").

2. Servicers should maintain policies, procedures and guidelines that are reasonably designed to identify and manage any actual or perceived conflicts of interest that may arise in connection with their loan modification activities and decision making. Such policies, procedures and guidelines should address, among other topics, situations in which a servicer (a) has an ownership interest in one or more classes of bonds supported by principal and/or interest collections on subprime mortgage loans that it services; (b) receives servicing fees or other compensation that is tied to various attributes of subprime mortgage loans that it services (e.g., outstanding principal balance, delinquency/default status); and (c) is not reimbursed for the costs of loan modifications from collections on subprime mortgage loans that it services.

3. Securitization operative documents should clearly state, for purposes of "delinquency triggers" or "cumulative loss triggers" which control whether excess cash flow may be released to the residual, the following: (a) whether and under what conditions a modified loan is to be considered "current", and (b) whether and how any interest rate reduction or forgiveness of principal resulting from a loan modification should be treated as a realized loss.

4. As an urgent, high priority matter, the ASF should develop guidelines under which delinquency triggers and cumulative loss triggers in securitization operative documents, which control whether excess cash flow may be released to the residual, should be interpreted in a manner consistent with the parties' intent and in a manner that appropriately reflects any loan modifications that have occurred. It is the sense of investors that (a) any partial forgiveness of principal should be treated as a loss for purposes of cumulative loss triggers, and (b) a modified loan performing in accordance with its modified terms should be treated as delinquent for purposes of delinquency triggers for some appropriate period of time.

5. Greater clarity, transparency and consistency should be established regarding how any interest rate reduction or forgiveness of principal resulting from a loan modification should be reflected for purposes of investor reporting, and for purposes of allocating payments for the cash flow waterfall.

6. Consistent with the foregoing recommendations, servicers should not make decisions to use or not use loan modifications for the purpose of

manipulating the application of delinquency triggers or cumulative loss triggers which control whether excess cash flow may be released to the residual.

7. The ASF will conduct a survey of typical document provisions and interpretations, on the question of whether and under what conditions a modified loan is to be considered current for purposes of investor reporting, and for purposes of delinquency triggers and cumulative loss triggers which control whether excess cash flow may be released to the residual. Additional guidelines should be developed and recommendations should be made and evaluated regarding amendments to securitization transactional documents, based on the results of this survey.

B. *Future securitizations:*

1. The ASF will develop standard, uniform model contractual provisions governing the servicer's ability to provide loan modifications for use in future securitizations. Such provisions should expressly authorize the actions referenced in Loan Modification Interpretive Guidance point 1 above.

2. Use of an increased or supplemental servicing fee should be considered for loans that have been modified to defray the additional costs of administering modifications.

3. The ASF will develop standard, uniform model contractual provisions, both as to timing and priority, to govern the servicer's ability to obtain reimbursement for P&I advances and servicing advances made in respect of loans where there has been a loan modification, or where other types of loss mitigation have been used.

MARY JANE M. SEEBACH
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August 20, 2007

The Honorable Michael Machado
Chair, Senate Committee on Banking, Finance and Insurance
California State Senate
State Capitol, Room 5066
Sacramento, California 95814

Re: Hearing on "Preserving the American Dream: Homeownership Preservation and the Subprime Mortgage Crisis"

Dear Chairman Machado:

I want to reiterate my thanks to you for calling an informational hearing on "Preserving the American Dream: Homeownership Preservation and the Subprime Mortgage Crisis." I also want to thank you for offering Countrywide an opportunity to address the Senate Banking, Finance & Insurance Committee. Unfortunately, as you know, we are not able to accept your invitation to testify in person tomorrow. However, in lieu of personal testimony, we respectfully submit the enclosed statement to the Committee describing some of Countrywide's activities to advance and preserve homeownership. We would appreciate your including it in the record of the hearing.

Thank you again for focusing on these important issues. Please do not hesitate to contact me if you have any questions.

Sincerely,

Mary Jane M. Seebach

Mary Jane M. Seebach
Managing Director, Public Affairs

cc: Senate Committee on Banking, Finance and Insurance
Thomas McMorrow; Mannatt, Phelps and Phillips

CALIFORNIA SENATE BANKING, FINANCE
& INSURANCE COMMITTEE
Statement from
Countrywide Financial Corporation
August 21, 2007

Countrywide Financial Corporation ("Countrywide") applauds Chairman Machado and the members of the Senate Banking Committee for continuing to focus on how we can best assist those California consumers who are currently having difficulties with their mortgage payments. Countrywide's comprehensive efforts to prevent foreclosures and preserve borrowers' ability to stay in their homes are longstanding and pre-date the ongoing challenges in the housing market. In addition to these proven programs, we continue to explore new ways to work with our borrowers. Both in terms of our principles and our business practices, a home lost to foreclosure is also a loss to Countrywide. It is in Countrywide's best interest to preserve our borrower's dream of homeownership and whenever possible, avoid foreclosure.

Working with our borrowers

Countrywide makes every effort to work with our borrowers who are experiencing financial hardships. Our home retention programs are designed to reach distressed borrowers in order to evaluate their individual situations and develop customized solutions. The reasons people suffer financial setbacks are as varied as people's individual circumstances. As a result, the solutions we offer must be tailored to meet the individual needs and circumstances of each borrower.

One of the biggest challenges faced by lenders is making contact with borrowers who face financial difficulty. Freddie Mac has estimated that as many as 50% of borrowers that lose a home to foreclosure never responded to lender efforts to contact them. This lack of communication can have significant consequences. For example, in 2006, when a customer contacted Countrywide to inform us of an inability to make their payment due to hardship, we were able to establish a workout plan with the borrower 80% of the time. However, many borrowers are unaware of options available to avoid foreclosure, and this lack of knowledge causes them to avoid contact with their lender

We encourage our borrowers to call us the very first time they anticipate problems with sending in the mortgage payment and to provide us a good sense of their ongoing financial capabilities. With this information, we can usually offer real solutions that are good for families in need, our communities and the investors who own these mortgages.

Countrywide recognizes that homeowners are sometimes reluctant to contact a lender when their payments become delinquent. We reach out to borrowers in a variety of ways:

- To encourage communication, we include helpful information in borrowers' monthly statements and attempt to reach our borrowers by letter and by phone.

- We utilize other methods to get information out to borrowers who are not responsive to our outreach by mail and phone. For example, we provide borrowers with a DVD that they can view in the privacy of their own homes that explains the possible repayment options. We also mail out a copy of our brochure entitled ***"Keeping the dream of homeownership: Solutions for the times when hardship makes it difficult to meet a monthly home loan payment."*** This brochure includes our toll-free number for borrowers (1-877-327-9225) to contact our dedicated team of specialists. Finally, we are working on another strategy that would allow homeowners to access a secure website where they could obtain information about a possible workout, modification or other solution.

- We appreciate the diversity of our borrowers and the communication issues that can arise. For those who would prefer to communicate in Spanish, Countrywide has phone teams fluent in Spanish and provides automated phone services, correspondence, and website assistance in Spanish.

- Countrywide extends its outreach to distressed homeowners in their own communities. Our HOPE (HOPE: **H**elping homeowners, **O**ffering solutions, **P**reventing foreclosures, **E**nvisioning success) team specialists travel to our local branch offices around the country to personally meet with our borrowers who need help.

- Countrywide will continue to maximize our efforts to reach and communicate with our borrowers by forming partnerships with local and national nonprofit counseling organizations in order to make the important connection with our borrowers. Our efforts have included co-branding joint communication letters and advertisements encouraging the borrowers to contact either Countrywide directly or to work with a third party counselor who can assist them through the process. This has been extended by having local counselors make 'face-to-face' contact with the borrowers, inviting them to work with us. To support the efforts of the many local counseling agencies around the country, we have established a dedicated contact system (via phone and email) that allows the counseling agencies working with our borrowers to quickly contact Countrywide's HOPE team specialists and identify what we can do to assist our borrowers.

- Countrywide is a founding sponsor of the Homeownership Preservation Foundation ("HPF"), a national nonprofit foreclosure prevention counseling agency that assists borrowers in all markets, every day. The most important development in assisting borrowers in trouble is the "1-888-995-HOPE" hotline developed by the HPF with the support of Countrywide and others in the mortgage lending industry (www.995hope.org).

- In June 2007, HPF in conjunction with the national Ad Council, launched a multimedia campaign for the "1-888-995-HOPE" hotline. The campaign is geared to providing borrowers with a trusted direct point of contact for foreclosure assistance. Borrowers are often bombarded with foreclosure rescue scams and other solicitations directing them to untrained counselors or untrustworthy organizations.

- Countrywide hosts homeownership preservation seminars in local communities. These seminars are designed to bring together lenders and housing counselors to educate our borrowers and the general public on the options available to avoid foreclosure. We have held such seminars in cities as diverse as Fresno, Dallas, Cleveland, and New York. We also provide free access to counseling, including third party counseling from community organizations like Neighborhood Housing Service. Across the country, Countrywide works with almost 60 different counseling organizations.

Every borrower's situation is different, and this often drives the options that are available when the borrower encounters financial difficulties. As a result, there is no "one size fits all" formula that a servicer/lender (or a third party) should or could impose on all distressed borrowers. On the other hand, this highly individualized approach enhances flexibility and means that Countrywide can work closely with each borrower.

We offer the following as specific examples of workouts and loan modifications involving California borrowers. Though we are using generic descriptions to protect the identities and privacy of the borrowers involved, these descriptions still reveal a range of circumstances borrowers encounter and options that lenders and borrowers can pursue by working together:

- The borrower suffered a severe medical condition and as a result, now receives full-time care from a family member and a limited fixed income amount. Countrywide was able to capitalize four delinquent payments and place the borrower on a step rate, initially bringing the interest rate down from 7.5% to 5.5% for two years that will then go up to 6.5% for one year before moving back to the borrower's original fixed rate of 7.5% for the remaining term of the loan.

- The borrowers' first set back occurred when the primary wage earner was laid off. Though able to secure a better paying job after several months, the borrowers fell behind on the mortgage payments. The borrowers agreed to a nine-month repayment plan that anticipated payments being made in addition to the usual monthly amount. Unfortunately, during this time the borrowers fell behind again due to an illness in the family. Following this new hardship, Countrywide completed a loan modification that capitalized all of the delinquent payments and allowed the borrowers to remain current.

- The borrower experienced a very difficult time in her life with the recent deaths of both a spouse and child. In addition to dealing with these devastating personal losses, the borrower was facing financial problems in covering the costs of both funerals. The borrower accepted our offer for a loan modification that capitalized the delinquent payments and has allowed the borrower to remain current going forward.

- The borrower is a single parent who has battled cancer for the last two years and has had several medical operations. The workout involved a loan modification and rate reduction from 8.4% to a fixed rate of 7.9% that decreased the borrower's monthly payments.

Currently Countrywide has more than 8.8 million borrowers. In July 2007, Countrywide completed 6,331 workout closings. A closing is defined as a completion of a specific workout program, such as a repayment plan, modification, short sale, etc. During that same time period, 55,432 loans were in some stage of workout including being monitored, processed or evaluated on a specific workout program leading to an eventual closing.

Countrywide acknowledges that not every delinquent borrower will be able to avoid foreclosure proceedings. Still, in our 38 years in business, less than 1% of the loans Countrywide has ever made or bought have actually gone through to a foreclosure sale. In those unfortunate circumstances where the borrower does not have the ability to maintain payments or adhere to a reasonable workout plan, Countrywide still works with those borrowers to determine whether they can still avoid the economic consequences of a foreclosure. These remedies do involve a loss of the home and include short sales where the lender accepts sales proceeds in an amount less than the outstanding debt, an assumption of the loan by the buyer, if the loan permits, and a deed in lieu of foreclosure.

Market constraints

Notwithstanding the multitude of scenarios and potential responses, servicers are required to observe accounting and contractual obligations that limit their ability to offer certain workout or loan modification alternatives. Some of those limits and available options are defined by the pooling and serving agreements and the trust documents that accompany each securitization. The contractual obligations can include limits on the type or total number of modifications and may require servicers to obtain investors' approval. With United States Senator Christopher Dodd's encouragement, robust discussion continues on a national level among servicers and investors on how to best work within these constraints and appropriately assist borrowers experiencing financial difficulties.

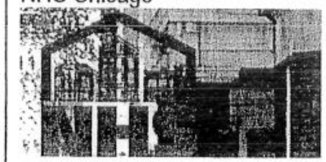
Conclusion

Countrywide appreciates this opportunity to share information about the steps we are taking to help our borrowers and create sustainable homeownership. Our primary message to delinquent homeowners is this: Countrywide wants to help. Delinquent homeowners who contact and communicate with their lender have access to solutions. Unfortunately, homeowners who do not communicate with their lenders may miss out on home saving opportunities. We understand that some borrowers might be fearful or embarrassed to speak with their lender. Together with the legitimate third party counselors, you and the lending industry can find ways to help delinquent homeowners keep their homes.

HSBC – North America
Center for Consumer Advocacy
HOME PRESERVATION OFFICE

HSBC

Program	Effective Date	Description	Partner	Consumers Helped
Consumer Rescue Loan Program	2002	$25MM Loan Fund to rescue consumers from mortgage loans that have become unaffordable. Loans are booked through HFC branch offices: • Subsidized Interest Rates • No PPP • No Points • No Fees/Loan Processing Costs	National Community Reinvestment Coalition (NCRC) NATIONAL COMMUNITY REINVESTMENT COALITION NCRC	Non-HSBC Customers Only
Foreclosure Avoidance Program	2004	$82MM commitment (currently >$105MM) to provide assistance, through homeowner counseling and loan modification, to customers who are experiencing financial hardship. • Immediate suspension of foreclosure proceedings • Permanent and/or temporary hardship relief • Interest rate reductions to ensure a TDI (target disposable income) threshold • Late charges are waived; Deferral of accrued, unpaid interest	Association of Community Organizations for Reform Now (ACORN) [redacted]	HSBC Customers Only
NeighborWorks Center for Foreclosure Solutions	2006	HSBC is a national partner in this initiative to reach consumers before foreclosure, provide counseling and preserve homeownership. • 24 national partners, including GSEs. • Provides toll-free 24/7 counseling (1-888-995-HOPE) • National Ad Council campaign will launch July 2007.	NeighborWorks America NeighborWorks AMERICA (Other Partners – ABN-AMRO, American General, Bank of America, Chase, Citi, Countrywide, Homecomings, Freddie Mac, FannieMae, National City, New Century, Option One, Ocwen, ResCap, State Farm, Wells Fargo, WaMu)	All Consumers including HSBC Customers
PHASES (Preserving Homeownership and Savings Education Strategy)	2007	$1MM initiative funded by HSBC Consumer Finance to provide bridge grants of up to $3,500 to qualified consumers facing a financial crisis (including mortgage delinquency). Support to include: • Bridge Loan • Debt Management/Homeownership Counseling • Dedicated Phone Line/Client Access website • Post-counseling follow-up and reporting	Money Management International	All Consumers including HSBC Customers

Program	Effective Date	Description	Partner	Consumers Helped
Chicago HOPI	2003	Homeownership Preservation Initiative (HOPI) -- Collaborative program with City of Chicago, lenders and community groups to reach Chicago homeowners at risk for foreclosure. • Chicago non-emergency hotline (311) is used to screen applicants. • Consumers receive telephone counseling provided by HUD-certified agencies and in-person counseling provided by NHS Chicago. • HSBC supports homeownership counseling sessions provided by NHS employees.	NHS Chicago 	All Consumers, including HSBC customers
New York PACE	2005	Preserve Assets and Community Equity (PACE) -- New York program modeled after Chicago HOPI program in cooperation with City of New York. • New York non-emergency hotline (311) is used to screen and route applicants. • NY Dept of Housing Preservation and Development leads marketing and consumer outreach programs. • Three non-profit partners execute the program.	• The Parodneck Foundation (Parodneck) • South Brooklyn Legal Services (SBLS) • Neighborhood Economic Development Advocacy Project (NEDAP)	All consumers, including HSBC customers
Momentive (Indiana)	2006	Momentive CCCS provides homeowner counseling for callers of the Indiana Mortgage and Foreclosure Helpline. • Project initiated by Congresswoman Julia Carson, Fannie Mae and Momentive. • HSBC provides a designated foreclosure contact	Momentive CCCS MOMENTIVE Lender Partners: • Bank of America • Chase • Citi • Countrywide • Irwin Mortgage • Fifth Third Bank	All consumers, including HSBC customers
Detroit HOPE	2006	Detroit HOPE – program modeled after Chicago HOPI initiative. Provides one-on-one counseling to homeowners facing foreclosure, provides homeowner preservation/counseling workshops.	City of Detroit and U-SNAP-BAC Focus: HOPE 45 Lender Partners, including: Chase, Charter One, Homecomings, New Century, Litton Loan Servicing, Citi, Ameriquest, National City,	All consumers, including HSBC customers

Statement of

Lupe Hernandez

Management Consultant, Homeownership for Neighborhood Reinvestment Corporation
(Now *doing business as* NeighborWorks® America)

Before the
California State Senate
Committee on Banking, Finance and Insurance

Hearing: "Preserving the American Dream: Homeownership Preservation and the Subprime Mortgage Crisis"

August 21, 2007

Chairman Machado, and Members of the Committee, my name is Lupe Hernandez, Management Consultant for Homeownership for NeighborWorks® America, and I appreciate the opportunity to talk with you today about NeighborWorks America and the efforts we and our partners are making to preserve homeownership.

NeighborWorks® America is a congressionally-chartered national non-profit organization that provides grants, technical assistance and training to more than 235 community based organizations across the country. For nearly 30 years, NeighborWorks America has created opportunities for people to live in affordable homes, improve their lives and strengthen their communities.

NeighborWorks® America is the original / public/ private partnership model. We have replicated this successful model in over 4,400 communities around the country. NeighborWorks® organizations operate in all 50 states, the District of Columbia and Puerto Rico; in America's urban, suburban and rural communities

Over the past five years NeighborWorks® has:

- Assisted nearly 100,000 families of modest means to become homeowners (of which, 91 percent are low-income and 53 percent are ethnic/racial minorities)
- Own and manage more than 63,500 units of affordable rental housing
- Provided homeownership education and counseling to more than 317,000 families
- Trained and certified nearly 50,000 community development practitioners from over 5,000 organizations and municipalities nationwide; and
- Facilitated the investment of nearly $9 billion in distressed communities across the country.

Today, my testimony will focus on our efforts to preserve homeownership and respond to the precipitous rise in foreclosures.

NeighborWorks® America has a 30-year history of supporting lending to non-conforming borrowers – including lower income families, borrowers with impaired credit and others who would not normally qualify for a conventional mortgage. By providing quality pre-purchase housing counseling, financial fitness training and working with borrowers to improve their credit rating, local NeighborWorks® organizations are able to present mortgage-ready borrowers who qualify for reasonably priced traditional mortgage loans and achieve sustainable homeownership.

From our experience, we know that the best defense against delinquency and foreclosure is objective education and advice before the borrower begins shopping for a home and selecting a mortgage product. And the best home buyer counseling is provided through objective, well-trained non-profit agencies (including local NeighborWorks® organizations and other HUD-approved nonprofit housing counseling agencies) that put the consumers' and the communities' interest first.

NeighborWorks® America has been tracking the loan performance of the many low-income families assisted by NeighborWorks® organizations over the years. These loans continue to perform significantly better than subprime loans.

In fact, a comparison of the loan performance of borrowers counseled by NeighborWorks® organizations (in the first quarter of 2007) indicates that their loans are:

- 10 times less likely to go into foreclosure than subprime borrowers;
- Nearly 4 times less likely to go into foreclosure than FHA borrowers; and
- Slightly less likely to go into foreclosure than Prime borrowers.

Several years ago, NeighborWorks® America recognized the impending foreclosure crisis and in response created the NeighborWorks® Center for Foreclosure Solutions, modeled on the successful trailblazing efforts of one of our local NeighborWorks® affiliates, Neighborhood Housing Services of Chicago.

The NeighborWorks® Center for Foreclosure Solutions was created to build the capacity of foreclosure counseling capacity across the nation, conduct public outreach campaigns to reach struggling homeowners, research local and national trends to develop strategic solutions and establish sustainable foreclosure intervention programs.

Foreclosure reaches far beyond the individual tragedies confronting homeowners. Foreclosed homes can threaten entire communities. The value of surrounding homes goes down and other homeowners will have difficulty selling or refinancing their homes, leading to further disinvestment in communities. As a result, property taxes collected will be lower, affecting schools and government services, creating a downward spiral that is detrimental to the entire community.

Lenders report that each foreclosure can cost them, on aggregate, from $30,000 to $50,000. And, studies confirm that foreclosures are much more likely to occur in high minority neighborhoods, even when all other variables such as borrower credit and income are held steady

NeighborWorks® America, in partnership with the Homeownership Preservation Foundation is promoting a national toll-free hotline for delinquent borrowers **(888-995-HOPE)** that is available 24/7 to provide callers with high quality telephone-based assistance (in English and in Spanish). Individuals needing more intense service than can be provided over the phone are referred to local HUD-approved housing counseling agencies, including local NeighborWorks organizations.

The key to helping as many people as possible through the **888-995-HOPE** hotline is to get people who are experiencing problems in paying their mortgage to call as soon as possible. Therefore, NeighborWorks® America has also launched a public service advertising campaign supported by the Ad Council, to decrease foreclosures by directing struggling borrowers to call the 888-995-HOPE hotline. The campaign has just launched and has been nationally distributed to over 30,000 media outlets. We anticipate that this effort will go a long way toward increasing public awareness of the 888-999-HOPE hotline and the reputable national and local resources available to help homeowners in financial distress.

Once the call is made, service begins immediately. They are connected with a trained counselor at the outset and depending on the problems, homeowners can get budgeting help, assistance developing a written financial plan, assistance contacting their lender to discuss payment options and loan restructuring, and a referral for face-to-face counseling through local HUD-approved housing counseling agencies.

As federal, state and local legislators, regulators and others wrestle to identify proposed actions to respond to the surge in foreclosures, I want to stress that denying credit to the type of people NeighborWorks® has served for decades (lower-income, families, minorities, people with blemishes on their credit reports) is not the answer.

In my view though, the real challenge continues to be how to create informed consumers and foreclosure-resistant borrowers.

Snapshot of the Foreclosure Problem in California/ HOPE Hotline Data

In California, over 30,000 homes are currently in foreclosure and another 59,000 are seriously delinquent. California's subprime arms are foreclosing at a rate 15 times greater than prime loans and 5.62% of those are in foreclosure. Many of the subprime mortgage delinquencies are highly concentrated in key metropolitan statistical areas including Sacramento, Modesto, Stockton-Lodi, Oakland, Merced, Vallejo, Yuba City, San Diego, and the Riverside San Bernardino.

According to the Homeownership Preservation Foundation, the HOPE hotline has received over 6100 calls from California homeowners in 2007 alone. In the first half of this year, 3300 California homeowners were counseled making it the 2nd most counseled state. This is compared to 650 homeowners in 2006.

Closing

In closing, let me state that from our experience, the best way to create foreclosure-resistant homeowners and in turn preserve homeownership is through quality pre-purchase housing counseling. NeighborWorks® America challenges the mortgage finance industry, financial regulators, real estate professionals, and legislators to work together to develop an appropriate combination of resources that support this work in the following areas:

Pre-purchase Side:

- Increased emphasis and support of quality housing counseling and consumer education
- Understandable and transparent loan disclosures for borrowers

Post-purchase Side:

- Resources to build and sustain post-purchase counseling efforts
- Encouragement of the lending and servicing industry to work with housing counselors and community groups to make their servicing operations more accessible to counselors

Regulatory Guidance:

- Improved oversight of lenders and brokers with a focus on curtailing predatory and deceptive lending practices
- Guidance to servicers/investors allowing them to initiate loan modifications despite securitization instruments

Real Estate Owned Properties (REO):

- Encouragement of the industry to help develop strategies to re-introduce REO stock back into the community

I trust this testimony gives you a sense of some of the challenges we are facing and our response to families facing foreclosure. I stand ready to answer any questions you may have.

- END -